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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
	)	
Forward-Looking Mechanism for High Cost Support for Non-Rural LECs	)	CC Docket No. 97-160
	)	

REPLY COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY, PACIFIC BELL, AND NEVADA BELL

Southwestern Bell Telephone Company, Pacific Bell, and Nevada Bell (collectively, the "SBC LECs") submit these Reply Comments to the comments filed pursuant to the Public Notice, DA 98-848 (released May 4, 1998), on selected issues regarding the proposed universal service forward-looking cost proxy model.

I. UNIVERSAL SERVICE NECESSARILY REQUIRES THE AVAILABILITY OF TELEPHONE SERVICE TO *ALL* HOUSEHOLDS[1]

The section 254 mandate to "preserve and advance" universal service can only be met by making telephone service available to all customers desiring telephone service. The mandate cannot be fulfilled by only counting "occupied housing units" or those "households who currently have phones" or "total housing units." None of the suggested alternatives fully

[1] By use of the term "household," the SBC LECs generally mean all premises within the geographic area to which facilities may be deployed, including business and residential locations.

captures the need to have facilities in place in advance of service demand, the dynamic nature of demand, and the movement of customers from location to location. Moreover, the latter does absolutely nothing to "advance" universal service but instead treats the current subscribership rate as a static objective that, if preserved, meets the Congressional goal. The Commission should thus adopt total housing units and all business locations as the input value to develop the total costs associated with universal service.

Several filings that support using total housing units noted that universal service has for years included the "carrier of last resort" obligation shouldered by incumbent local exchange carriers ("ILECs"). As GTE noted, that obligation includes a "readiness to serve" component that "takes into account that an ILEC must engineer its network and be prepared to provide immediate service to all customers in its area," which includes normal growth and customer churn factors. GTE, p. 9. Similarly, as stated in the joint comments of BellSouth, US WEST, and the Sprint LECs ("LEC Joint Comments"), "[w]hile at any given time, it is true that 100% of the housing units may not need telephone service, the plant is engineered to accommodate all the housing units, because any of the existing housing units may be occupied at any time." LEC Joint Comments, p. 7. Other commenters who actually have undertaken the responsibility of providing universal service agree.[2] Indeed, the FCC's obligation to "preserve" universal service

[2] *See*, for example, Aliant Communication which notes that "[i]f telephone plant is not constructed to all housing units intended for occupancy, it would need to be installed when a 'household' later moves in and subscribes to telephone service," "[o]mitting the investment to serve unoccupied (but intended for occupancy, as defined by the Bureau of Census) housing units understates the costs of providing service," and "[e]stimating the cost of serving only households with telephones at a given point in time is unnecessarily restrictive and not representative of the cost

and the definition of "eligible telecommunications carrier" in section 214(e) with its advertising requirement clearly suggests that the same "readiness to serve" standard applies to and is expected of eligible carriers. Accordingly, to provide support to "preserve" the current status of universal service (including the "readiness to serve" component), total housing units and total business locations must be adopted and the costs associated with deploying a network to those locations must be included in any proxy model.

The SBC LECs thus disagree with comments like those filed by the North Dakota Public Service Commission, which supports including "only occupied housing units." North Dakota PSC, p. 1. Ameritech's proposal to count only households with telephones is equally flawed. Ameritech reasons that to "develop cost for supported services using this universe [of households] will permit an adequate recognition of any economies of scale and scope to existing customers" and that to "expand the universe beyond households with telephones would unnecessarily clutter the calculation of the cost of supported services." Ameritech, p. 2. Telephone networks, and particularly outside plant, used to provide universal service are not deployed in a shotgun, scattered fashion only in reaction to consumers' demand as they move from occupied to unoccupied houses. Looking only at "total occupied housing units" or "households with telephones" does not account for the fact that plant must be deployed (and costs incurred) in preparation for service to unoccupied customer locations, or the fact that a

of providing service over time (even in a period as short as a week)." Aliant, p. 3.

currently unoccupied customer location may at one time been occupied and therefore required telephone service.

The use of any input other than total housing units and total business locations would be inconsistent with the stated objective in developing a forward-looking cost proxy model. As noted by Sprint Local Telephone Companies' ("LTCs") comments, the term forward-looking cost is defined as ". . . using the least cost, most efficient, and reasonable technology currently available for purchase with all inputs valued at current prices. Sprint LTC, p. 3. As noted by BellSouth, "[e]ven though cost proxy models design a hypothetical network, the cost of that network should reflect real world characteristics. That is, it should reflect the costs that an efficient provider would experience in building and operating that network." BellSouth, p. 4. Those "real world characteristics" would include total housing units and total business locations as the efficient engineering deployment of facilities needed to provide universal service (*e.g.*, copper/fiber, drop, electronics and switching capability) must address the timeliness of being able to provide such services to minimize delay and costs and meet legal obligations. It is simply not efficient, cost effective or timely to deploy telephone plant on a customer location-by-customer location basis depending upon the timing of when a customer location becomes occupied or to remove plant and facilities as homes become unoccupied. Any forward-looking cost proxy model that makes that assumption is fundamentally inconsistent and flawed.

II. ANY REVENUE BENCHMARK ADOPTED BY THE COMMISSION MUST BE LIMITED TO ONLY REVENUES GENERATED BY UNIVERSAL SERVICE PRICES

Only those revenues that are obtained from prices associated with the services and functionalities in the universal service definition should be included in the revenue benchmark. Implicit support essentially involves using revenues obtained from services priced above-cost, and presumably otherwise competitive levels, to permit the pricing of other services below cost.[3] AT&T and MCI advocate the continued use of implicit support by suggesting that all revenues that can be expected from the facilities placed to provide basic service should be included in establishing a revenue benchmark. AT&T/MCI even go so far as to suggest that revenues should be included from "currently nonexistent, revenue-producing services." AT&T/MCI, p. 16. Other commenters have suggested that all revenues generated as a result of having an end-user's local exchange service account should be included in the benchmark.

However, the prices currently charged for services such as intraLATA toll, access services and vertical services are several of the most common examples of implicit universal service support. Regulators have historically required these prices to be set well above cost in order to generate revenues necessary to keep universal service prices artificially low. Including these revenue levels in the revenue benchmark means only the implicit support they currently

[3] The Commission itself recognized this concept in its universal service order. At note 15, the Commission stated that it found the term "implicit subsidies" to "generally mean that a single company is expected to obtain revenues from sources at levels above 'cost' (i.e., above competitive price levels), and to price other services allegedly below cost." Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 12 FCC Rcd 8776 (1997).

contain will never be identified. The motivation is clear -- having one carrier's prices in a competitive market inflated with universal service support provides competitors with an unwarranted competitive advantage. In order to ensure competitive neutrality, it is imperative that all implicit support is replaced by an explicit support mechanism. Even if the current prices for intraLATA toll, access services and vertical services did not contain implicit support, it would be incorrect to include these revenues in the benchmark because it would understate the true amount of revenue necessary to recover the universal service costs in high-cost areas.

AT&T/MCI do not recognize that incumbent LECs as well as other eligible telecommunications carriers do not have the luxury of investing to serve only customers for which support may not be required. By nature of their service obligation, incumbent LECs and other eligible telecommunications carriers must invest to provide all customers with access to the network while at least incumbent LEC prices for that access continue to be regulated and constrained at levels not otherwise indicative of the market price. In high-cost areas, prices are constrained to below-cost levels. Conversely, in low-cost markets, prices may be constrained above the level that the market would dictate. In either market, the prices for services not included in the definition of universal service may be artificially inflated to produce the inappropriate, implicit support for universal service. There is no guarantee a customer will subscribe to vertical services or make enough toll calls to generate sufficient contribution to offset the costs of local service not recovered from that customer.

The SBC LECs further agree with USTA that "such revenues will no longer be available to support universal service as competitors with no regulatory restraints will continue to target high volume customers." USTA, p. 3. In any instance where an implicit subsidy exists in a price, competitors will easily be able to offer prices below those of the ILEC even when not as efficient as the ILEC. Services priced with embedded, implicit subsidies are simply not sustainable in a competitive market. Competition will necessitate that the ILECs lower their rates on those services providing the implicit subsidy, reducing support to the high-cost rural areas traditionally provided by the more densely populated urban areas. The result will be that the amount of support necessary to be funded through the state and federal universal service funds will be insufficient, as well as discriminatory since all carriers are not contributing to the support of universal service.

III. THE COMMISSION MUST RECOGNIZE, AS MANY COMMENTERS HAVE, THAT CONGRESS HAS MANDATED THAT UNIVERSAL SERVICE PRICES BE PREMISED ON AFFORDABILITY

Section 254(i) states that "[t]he Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable." The definition of affordability from a regulatory perspective should include the customer's ability to bear the cost for universal service. Such an approach would focus on customers within a given geographic area and determines whether or not it is reasonable for customers to pay for the costs of providing them universal service, or whether support is necessary to ensure affordable prices.

Comments filed by the Sprint LTCs indicate an awareness that the FCC should focus on affordability as the premise for any revenue benchmark. Sprint LTCs, p. 4. With the concept of affordability, universal service prices may need to either increase or decrease, depending on the specific geographic area in question. In order to meet the universal service goals under the Act, the affordability of the required price must be assessed to determine if support is necessary.

The SBC LECs disagree with comments that the universal service benchmark should be based solely on cost. *See*, *e.g.*, US West, p. 7. Cost should, and must, be used in the determination of support, but it is only one of the necessary components. However, the need for support should be determined by a comparison of the customer's ability to pay for universal service -- affordability -- with the actual costs of the service. To the extent that the costs exceed the customer's affordability level, the resulting difference is the needed support. If the revenue received from the universal service equals or exceeds the affordability benchmark, support is not needed. A cost benchmark is flawed because it delivers support to a company when a cost threshold is exceeded regardless of what the company's customers pay or can afford to pay for their universal service. One cannot simply assume that the costs of an area characterize the ability of the customers within that area to pay for universal service.

The FCC should begin the process of adopting an affordability based revenue benchmark using the multi-step approach most recently proposed in the SBC LECs' Comments filed in response to the Public Notice. The following three steps should be taken to ensure that universal service support remains available while continuing to evolve toward a full affordability-based revenue benchmark: (1) initialize the new federal universal service funding mechanism in the immediate time frame, (2) implement a transitional revenue benchmark, and (3) implement an affordability-based revenue benchmark concurrent with the annual access filings for the year 2000.

Respectfully submitted.

SOUTHWESTERN BELL TELEPHONE COMPANY
PACIFIC BELL
NEVADA BELL

By: ______________________
Robert M. Lynch
Durward D. Dupre
Darryl W. Howard

Their Attorneys

One Bell Plaza, Rm. 3703
Dallas, Texas 75202
214-464-4244

June 12, 1998

CERTIFICATE OF SERVICE

I, Mary Ann Morris, hereby certify that the foregoing, "REPLY COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY, PACIFIC BELL, AND NEVADA BELL," in CC Docket Nos. 96-45 and 97-160 have been filed this 12th day of June, 1998 to the Parties of Record.

Mary Ann Morris

Mary Ann Morris

June 12, 1998

THE HONORABLE WILLIAM E KENNARD,
CHAIRMAN
FEDERAL COMMUNICATIONS COMMISSION
1919 M STREET, N.W., ROOM 814
WASHINGTON, DC 20554

THE HONORABLE MICHAEL K POWELL
COMMISSIONER
FEDERAL COMMUNICATIONS COMMISSION
1919 M STREET, N.W., ROOM 844
WASHINGTON, DC 20554

THE HONORABLE SUSAN NESS,
COMMISSIONER
FEDERAL COMMUNICATIONS COMMISSION
1919 M STREET, N.W., ROOM 832
WASHINGTON, DC 20554

THE HONORABLE HAROLD W FURCHTGOTT-ROTH, COMMISSIONER
FEDERAL COMMUNICATIONS COMMISSION
1919 M STREET, N.W., ROOM 802
WASHINGTON, DC 20554

THE HONORABLE GLORIA TRISTANI
COMMISSIONER
FEDERAL COMMUNICATIONS COMMISSION
1919 M STREET, N.W., ROOM 826
WASHINGTON, DC 20554

THE HONORABLE JULIA JOHNSON, STATE
CHAIR, CHAIRMAN
FLORIDA PUBLIC SERVICE COMMISSION
2540 SHUMARD OAK BLVD.
GERALD GUNTER BUILDING
TALLAHASSEE, FL 32399-0850

THE HONORABLE DAVID BAKER,
COMMISSIONER
GEORGIA PUBLIC SERVICE COMMISSION
244 WASHINGTON STREET, S.W.
ATLANTA, GA 30334-5701

THE HONORABLE SHARON L. NELSON,
CHAIRMAN
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION
1300 SOUTH EVERGREEN PARK DR. S.W.
P.O. BOX 47250
OLYMPIA, WA 98504-7250

THE HONORABLE LASKA SCHOENFELDER,
COMMISSIONER
SOUTH DAKOTA PUBLIC UTILITIES
COMMISSION
STATE CAPITOL, 500 EAST CAPITOL STREET
PIERRE, SD 57501-5070

THE HONORABLE PATRICK H WOOD, III
CHAIRMAN
TEXAS PUBLIC UTILITY COMMISSION
1701 N CONGRESS AVE
P O BOX 13326
AUSTIN, TX 78711-3326

MARTHA S. HOGERTY
MISSOURI OFFICE OF PUBLIC COUNCIL
301 WEST HIGH STREET, SUITE 250
P.O. BOX 7800
JEFFERSON CITY, MO 65102

TOM POWER
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE CHAIRMAN
1919 M STREET, N.W., ROOM 814
WASHINGTON, DC 20554

CHARLES BOLLE
SOUTH DAKOTA PUBLIC UTILITIES
COMMISSION
STATE CAPITOL, 500 EAST CAPITOL STREET
PIERRE, SD 57501-5070

DEONNE BRUNING
NEBRASKA PUBLIC SERVICE COMMISSION
300 THE ATRIUM, 1200 N STREET,
P.O. BOX 94927
LINCOLN, NE 68509-4927

JAMES CASSERLY
FEDERAL COMMUNICATIONS COMMISSION
COMMISSIONER NESS'S OFFICE
1919 M STREET, N.W., ROOM 832
WASHINGTON, DC 20554

ROWLAND CURRY
TEXAS PUBLIC UTILITY COMMISSION
1701 NORTH CONGRESS AVENUE
P.O. BOX 13326
AUSTIN, TX 78701

BRIDGET DUFF, STATE STAFF CHAIR
FLORIDA PUBLIC SERVICE COMMISSION
2540 SHUMARD OAK BLVD.
TALLAHASSEE, FL 32399-0866

PAUL GALLANT
COMMISSIONER TRISTANI'S OFFICE
FEDERAL COMMUNICATIONS COMMISSION
1919 M STREET, N.W., ROOM 826
WASHINGTON, DC 20554

EMILY HOFFNAR, FEDERAL STAFF CHAIR
FEDERAL COMMUNICATIONS COMMISSION
ACCOUNTING AND AUDITS DIVISION
UNIVERSAL SERVICE BRANCH
2100 M STREET, N.W., ROOM 8617
WASHINGTON, DC 20554

LORI KENYON
ALASKA PUBLIC UTILITIES COMMISSION
1016 WEST SIXTH AVENUE, SUITE 400
ANCHORAGE, AK 99501

SANDRA MAKEEFF
IOWA UTILITIES BOARD
LUCAS STATE OFFICE BUILDING
DES MOINES, IA 50319

PHILIP F. MCCLELLAND
PENNSYLVANIA OFFICE OF CONSUMER
ADVOCATE
1425 STRAWBERRY SQUARE
HARRISBURG, PA 17120

THOR NELSON
COLORADO OFFICE OF CONSUMER COUNSEL
1580 LOGAN STREET, SUITE 610
DENVER, CO 80203

BARRY PAYNE
INDIANA OFFICE OF THE CONSUMER COUNSEL
100 NORTH SENATE AVENUE, ROOM N501
INDIANAPOLIS, IN 46204-2208

TIMOTHY PETERSON, DEPUTY DIVISION CHIEF
FEDERAL COMMUNICATIONS COMMISSION
ACCOUNTING AND AUDITS DIVISION
2100 M STREET, N.W., ROOM 8613
WASHINGTON, DC 20554

JAMES B. RAMSAY
NATIONAL ASSOCIATION OF REGULATORY
UTILITY COMMISSIONERS
1100 PENNSYLVANIA AVE., N.W.
P.O. BOX 684
WASHINGTON, D.C. 20044-0684

BRIAN ROBERTS
CALIFORNIA PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102

KEVIN SCHWENZFEIER
NYS DEPT OF PUBLIC SERVICE
3 EMPIRE STATE PLAZA
ALBANY, NY 12223

TIANE SOMMER
GEORGIA PUBLIC SERVICE COMMISSION
244 WASHINGTON STREET, S.W.
ATLANTA, GA 30334-5701

SHERYL TODD (PLUS 8 COPIES)
FEDERAL COMMUNICATIONS COMMISSION
ACCOUNTING AND AUDITS DIVISION
UNIVERSAL SERVICE BRANCH
2100 M STREET, N.W., ROOM 8611
WASHINGTON, DC 20554

BELLSOUTH CORPORATION
BELLSOUTH TELECOMMUNICATIONS INC
M ROBERT SUTHERLAND
RICHARD J SBARATTA
REBECCA M LOUGH
1155 PEACHTREE STREET NE SUITE 1700
ATLANTA GA 30309-3610

US WEST INC
ROBERT B MCKENNA
JOHN L TRAYLOR
1020 19TH STREET NW SUITE 700
WASHINGTON DC 20036

SPRINT LOCAL TELEPHONE COMPANIES
JAY C KEITHLEY
SANDRA K WILLIAMS
1850 M STREET SUITE 1110
WASHINGTON DC 20036-5807

TDS TELECOMMUNICATIONS CORP INC
MARGOT SMILEY HUMPHREY
KOTEEN & NATFALIN LLP
1150 CONNECTICUT AVENUE NW SUITE 1000
WASHINGTON DC 20036

ITCS INC
TARA S BECHT
IRWIN CAMPBELL & TANNENWALD PC
1730 RHODE ISLAND AVE NW SUITE 200
WASHINGTON DC 20036

PUERTO RICO TELEPHONE COMPANY
JOE D EDGE
TINA M PIDGEON
DRINKER BIDDLE & REATH LLP
901 15TH STREET NW STE 900
WASHINGTON DC 20005

ROBERT A MAZER
ALBERT SHULDINER
COUNSEL FOR ALIANT COMMUNICATIONS CO
VINSON & ELKINS LLP
1455 PENNSYLVANIA AVENUE NW
WASHINGTON DC 20004-1008

DAVID N PORTER
VP - GOVERNMENT AFFAIRS
WORLDCOM INC
1120 CONNECTICUT AVE NW SUITE 400
WASHINGTON DC 20036

DAVID L LAWSON
SCOTT M BOHANNON
1722 EYE STREET NW
WASHINGTON DC 20006

MARK C ROSENBLUM
PETER H JACOBY
295 NORTH MAPLE AVENUE
ROOM 3245H1
BASKING RIDGE NEW JERSEY 07920

MCI TELECOMMUNICATIONS CORPORATION
CHRIS FRENTRUP
SENIOR ECONOMIST
1801 PENNSYLVANIA AVENUE NW
WASHINGTON DC 20006

GAIL L POLIVY
GTE SERVICE CORPORATION
1850 M STREET NW
SUITE 1200
WASHINGTON DC 20036

RICHARD MCKENNA
GTE TELEPHONE OPERATIONS
600 HIDDEN RIDGE
IRVING TX 75038

JEFFREY S LINDER
GREGORY J VOGT
SUZANNE YELEN
WILEY REIN & FIELDING
1776 K STREET NW
WASHINGTON DC 20006

LARRY A PECK
MICHAEL S PABIAN
ATTORNEYS FOR AMERITECH
2000 WEST AMERITECH CENTER DRIVE
ROOM 4H82
HOFFMAN ESTATES IL 60196-1025

BELL ATLANTIC TELEPHONE COMPANIES
JOSEPH DI BELLA
1320 NORTH COURT HOUSE ROAD
8TH FLOOR
ARLINGTON VIRGINIA 22201

ITS
1231 20TH STREET NW
GROUND FLOOR
WASHINGTON DC 20036

MAGALIE ROMAN SALAS
SECRETARY-FCC
1919 M STREET NW ROOM 222
WASHINGTON DC 20554

KATHLEEN Q ABERNATHY
DAVID A GROSS
AIRTOUCH COMMUNICATIONS INC
1818 N STREET NW SUITE 800
WASHINGTON DC 20036

LINDA NELSON ACTING DIRECTOR
INFORMATION TECHNOLOGY PROGRAM
DEPARTMENT OF MANAGEMENT SERVICES
4050 ESPLANDE WAY
TALLAHASSEE FLORIDA 32399-0950

STEPHEN L GOODMAN
HALPRIN TEMPLE GOODMAN & SUGRUE
1100 NEW YORK AVENUE NW
SUITE 650 EAST TOWER
WASHINGTON DC 20005

JOHN LAMB JR
NORTHERN TELECOM INC
2100 LAKESIDE BOULEVARD
RICHARDSON TEXAS 75081-1599

TERRY NORUM
ADMINISTRATIVE SECRETARY
SOUTH DAKOTA PUBLIC UTILITIES
COMMISSION
500 E CAPITOL
PIERRE SD 57501

DAVID J NEWBURGER
NEWBURGER & VOSSMEYER
COUNSEL FOR CAMPAIGN FOR
TELECOMMUNICATIONS ACCESS
ONE METROPOLITAN SQUARE STE 2400
ST. LOUIS MO 63102

MARK C. ROSENBLUM
PETER H JACOBY
AT&T CORP
295 NORTH MAPLE AVE
BASKING RIDGE NJ 07920

L MARIE GUILLORY
NATIONAL TELEPHONE COOPERATIVE
ASSOCIATION
2626 PENNSYLVANIA AVE NW
WASHINGTON DC 20037

WILLIAM W BINEK
CHARLES E JOHNSON
STATE OF NORTH DAKOTA
SPECIAL ASSISTANT ATTORNEYS GENERAL
STATE CAPITOL
BISMARCK NORTH DAKOTA 58505-0480

KEVIN S DILALLO
LEVIN BLASZAK BLOCK & BOOTHBY LLP
COUNSEL FOR AD HOC
TELECOMMUNICATIONS USERS COMMITTEE
2001 L STREET NW STE 900
WASHINGTON DC 20036

LARRY SARJEANT
UNITED STATES TELEPHONE ASSOCIATION
1401 H STREET NW STE 600
WASHINGTON DC 20005

LYNN GREER
CHAIRMAN
TENNESSEE REGULATORY AUTHORITY
460 JAMES ROBERTSON PARKWAY
NASHVILLE TN 37243-0505

RICHARD A ASKOFF
NATIONAL EXCHANGE CARRIER ASSOCIATION
100 SOUTH JEFFERSON ROAD
WHIPPANY NJ 07981